

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Morrow Analyst: Davi Milam Bill Number: SB 49X
Related Bills: See Legislative History Telephone: 845-4073 Introduced Date: February 22, 2001
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Excessive Energy Costs Credit

SUMMARY

This bill would provide a credit for any excessive energy costs paid by residential or commercial customers.

PURPOSE OF THE BILL

The purpose of this bill appears to be to grant financial relief to individual and commercial energy customers for the high energy prices being experienced in California.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. The credit would be operative for taxable years beginning on or after January 1, 2001, and before January 1, 2005.

POSITION

Pending.

Summary of Suggested Amendments

Amendments are needed to modify the formula used to compute excessive energy costs. See "Implementation Considerations" below. Department staff is available to assist the author with these and any other amendments.

ANALYSIS

FEDERAL/STATE LAW

Both state and federal law allow a deduction for all ordinary and necessary expenses of a trade or business, including expenses relating to energy costs.

Deductions for the personal expenses of an individual taxpayer, such as energy costs, are generally not allowable. Individual taxpayers may itemize deductions for such items as excess medical expenses, charitable contributions, mortgage interest, and property taxes.

Board Position:

<input type="checkbox"/> S	<input type="checkbox"/> NA	<input type="checkbox"/> NP
<input type="checkbox"/> SA	<input type="checkbox"/> O	<input type="checkbox"/> NAR
<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Gerald H. Goldberg

04/16/01

State and federal laws provide various tax credits designed to provide tax relief for taxpayers that must incur certain expenses (e.g., renter's credit) or to influence behavior, including business practices and decisions (e.g., research credits).

Neither state nor federal laws have a credit comparable to the credit proposed by this bill.

THIS BILL

This bill would allow a credit equal to the amount of "excessive energy costs" paid or incurred during the taxable year.

The bill would define "energy costs" to mean the amount paid or incurred by a taxpayer during the taxable year for energy supplied by an electrical corporation, as defined by the Public Utilities Code, or a local publicly owned energy utility, including an irrigation district that supplies energy to residential and commercial customers.

An "electrical corporation" would include every corporation or person owning, controlling, or operating, or managing, any electric plant for compensation within this state, except where electricity is generated on or distributed by the producer through private property solely for its own use or the use of its tenants and not for sale or transmission to others.

The bill would define "excessive energy costs" to mean the product of the following two amounts:

- The taxpayer's energy costs for the taxable year; and
- The excess of the energy component of the federal Consumer Price Index (CPI) for the region or area that is nearest to the taxpayer's principal residence or principal place of business, over 110% of the national average of the energy component of the federal CPI.

The bill would not allow any otherwise allowable deduction for that portion of costs paid or incurred for the taxable year that is equal to the amount of this credit allowed.

Any excess credit could be carried forward to subsequent years

The bill also would express Legislative findings and make declarations regarding the impact of high-energy prices on individual and commercial energy consumers.

IMPLEMENTATION CONSIDERATIONS

The bill would raise the following implementation concerns. Department staff is available to assist the author with any necessary amendments.

The credit would be based on the taxpayer's excessive energy costs as determined by a formula. However, the formula may not work as the author intended. The second component of the formula calculates the excess of the energy component of the federal CPI for the taxpayer's area over 110% of the national average of the energy component of the federal CPI. The resulting number is then multiplied by the taxpayer's energy costs. Since the calculation does not result in a percentage, a taxpayer could potentially claim a credit for an amount in excess of the taxpayer's energy costs. For example, when comparing the January 2001 CPIs for the San Francisco-Oakland-San Jose region to the federal CPI and inputting the figures into the bill's formula, the resulting figure is 20.75. Thus, if this number is multiplied by the taxpayer's energy costs, for every dollar spent the taxpayer would receive a \$20.75 credit.

If the author intends to provide a credit to compensate the taxpayer for the excess of the amount paid for energy in California over the amount that would have been paid at national prices, the formula would need to be revised.

In addition, there are a number of other concerns related to the CPI:

- The bill does not identify the date for which the CPIs would be determined, or whether an average CPI for the taxable year should be used.
- The bill determines excessive costs by reference to the federal CPI for the region or area that is nearest the taxpayer's residence or principal place of business. Only three geographic regions are reported for California: Los Angeles-Riverside-Orange County, San Diego, and San Francisco-Oakland-San Jose. A statewide average is also reported. All other areas would need to use the statewide average CPI or one of these three regions. The bill does not specify how the taxpayer's region or area CPI would be determined for communities that outside the three regions or equidistant from two regions. Further, the bill does not limit the regional CPIs to California regions.
- The energy component of the CPI includes natural gas piped, fuel oil, electricity, and gasoline.

The bill provides a credit for costs of "energy" but does not further define energy. However, the credit is limited to energy supplied by an electrical corporation or a local publicly owned energy utility. As a result, costs for energy other than electrical energy (i.e., natural gas) received from a local publicly owned energy utility would be eligible for the credit whereas natural gas from a gas corporation would not. If this is not the author's intent, the bill should be amended.

The bill does not limit the number of years for the carryover period. The department would continue to retain the carryover on the tax forms indefinitely because an unlimited credit carryover period is allowed after the credit itself has expired. Recent credits have been enacted with a carryover period limitation since experience shows credits are typically used within eight years of being earned.

LEGISLATIVE HISTORY

SB 571 (Morrow, 2001/2002) contains the same language as contained in this bill. Currently, both bills are in the Senate Revenue and Taxation Committee.

PROGRAM BACKGROUND

AB 1890 (Stats. 1996, Ch. 854) restructured the California energy market from the regulatory framework existing on January 1, 1997, to a framework under which the Legislature intended to provide a competitive electric generation market. As a result of this legislation, among numerous other changes, retail electric rates for residential and small commercial customers were reduced from the rates in effect on June 10, 1996, and then were fixed by AB 1890 for a transition period that will end March 31, 2002. Thus, the California Public Utilities Commission (PUC) sets the amount that utilities may charge consumers for electricity but does not restrict the amount that energy generators may charge utilities.

OTHER STATES' INFORMATION

Although *Florida, Illinois, Massachusetts, Michigan, Minnesota, Michigan, and New York* do not provide a tax credit comparable to the credit proposed in this bill, the following is a brief list of some incentives provided for related to energy. The laws of these states were reviewed because their tax laws are similar to California's income tax laws.

Michigan: provided a credit through 2000 for heating fuel costs for a low-income taxpayer's homestead. For 1988, costs eligible for the credit were limited to \$1,190. This amount was adjusted by the Detroit consumer price index for fuels and other utilities.

Massachusetts: Currently has an energy credit that is equal to 15% of the net expenditures or \$1,000 whichever is less.

New York: For personal income tax only, New York allows a credit for solar generating equipment equal to 25% of certain solar generating expenditures. The credit is capped at \$3,700 per system.

FISCAL IMPACT

If the implementation considerations addressed in this analysis are resolved, the department's costs are expected to be minor.

ECONOMIC IMPACT

As currently drafted, the revenue impact of this measure would be exorbitant, in the billions annually, potentially eliminating the tax liability for the vast number of income tax filers.

The amount of the credit calculated under this measure is the product of two components. The first component is the taxpayers energy cost for the taxable year. The second component is the excess of the energy component of the CPI for the region or area that is nearest to the taxpayer's principal residence or place of business, over 110% of the national average of the energy component of the federal CPI.

For 2000, the average of the seasonally unadjusted energy components CPI for the three California regions for which this index is calculated was 134.4. The corresponding federal index was 124.6, which at 110% equals 137. Currently the California PUC has approved rate increases of up to 40%. Assuming that this would increase the California average energy CPI by 10%, the California index would increase to 147.8. The difference in the indexes, therefore, would equal to 10.7. California electricity bills for taxable entities in 2000 was estimated to be about \$25 billion. This resulted in an estimated tax credit amount of \$250 billion.

ARGUMENTS/POLICY CONCERNS

The bill does not clearly restrict the energy costs to those paid or incurred in California. Although the definition of electrical corporation refers to an electric power plant in this state, the credit also would be allowed for costs for energy from a local energy utility. The bill does not require that the local energy utility be in this state. Thus, a taxpayer that operates a business both within and without California could compute the credit on the amount paid or incurred for energy costs both within and without this state.

This bill could provide a credit in excess of the amount paid or incurred by the taxpayer for energy costs. Credits are typically based on a percentage of the costs paid or incurred. A credit of 100% or more, as this bill would provide, is unprecedented.

The bill does not require the energy costs or the credit amount to be reduced by the amount of any financial incentive or grant received from a local, state, or federal government, or any utility.

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